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IN THE

Supreme Court of the United States

October Term, 1960

LEO L. LOWY,

Petitioner.

AGAINST

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

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OCTOBER TERM, 1960

LEO L. LOWY,

Petitioner,

AGAINST

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

LEO L. LOWY, your petitioner, prays that a writ of certiorari be issued to review the judgment of the U. S. Court of Appeals for the Second Circuit, entered in the above-entitled case on April 4, 1961.

Opinions Below

The findings of fact and memorandum opinion of the Tax Court of the U. S. were entered on June 3th, 1960 in Docket #63613-T. C. Memo 1960-32 and are printed at 29a to 39a of the Appendix. The memorandum opinion

of the Tax Court is not officially reported. The opinion of the U. S. Court of Appeals for the Second Circuit is reported at 288 F. 2d 517 and is appended hereto as Apx. "A."

Jurisdiction

The judgment of the U. S. Court of Appeals for the Second Circuit was entered on April 4th, 1961. A copy thereof is appended hereto as Apx. "B".

The jurisdiction of this Court is invoked under Title 28 U. S. Code, Section 1254(a) and Section 7482(a) of the Internal Revnue Code of 1954.

Statutes and Constitutional Provisions Involved

The statutes involved are Sections 275(a), 276(a), and 1112(a), of the Internal Revenue Code of 1939. The constitutional provision involved is the due process provision of the Fifth Amendment.

Crucial Issue

The crucial issue on trial turned on whether the Commissioner sustained his statutory burden of proof (Section 112 I. R. Code--1939) of fraud with intent to evade tax in respect of the omission of the single item of $13,509.83 steel scrap sales proceeds from his 1944 income tax return (op. Court of Appeals, 288 F. 2d 517, p. 519 *supra*). If he did not, the Statute of Limitations time-bars any assessment (Section 275 I. R. Code 1939).

Questions Presented

(1) Does the judgment under review, imposing as it does staggering tax penalties, accord petitioner "due process", where the record makes demonstrably clear that the witnesses, sworn by respondent to prove fraud, exculpated petitioner from any taint of fraud?*

(2) Can a judgment resting upon nothing stronger than suspicion outweigh the uncontradicted, unimpeached and positive evidence upon the crucial and determinative factual issue?

(3) Devoid of supporting evidentiary proof, does the judgment on the crucial fraud issue contravene petitioner's rights to "due process" accorded under the Fifth Amendment? Otherwise put, does the judgment below which inflicts economic death upon petitioner, accord with the concept of "due process" under the Fifth Amendment where the judgment is founded on suspicion, though repelled and negated by positive, unimpeached proof of witnesses sworn by respondent in support of that issue?

Gravity of Assessment

The tax consequence of the finding of fraud upon the *single item of scrap sales*, omission of $13,509.88, is catastrophic to the taxpayer! It carries in its wake a total tax liability (together with fraud penalties and an additional 100% for interest running back to 1944) reaching a staggering sum in excess of $1,600,000. *It is an economic death warrant!*

---

* Proof of these witnesses upon the crucial issue stands uncontradicted, unimpeached and is not inherently improbable. In neither argument nor briefs did Commissioner contend to the contrary at any time!

It is respectfully urged that, in view of the gravity of the issue to the taxpayer, who after a lifetime of toil (he is past 72 and in ill health, Apx, 165a, 170a, 171a), stands doomed by the decision below, the record should be reviewed with the greatest circumspection.

Statement

This proceeding involves a petition for writ of certiorari to review the opinion of the U. S. Court of Appeals for the Second Circuit upholding the determination of the U. S. Tax Court that deficiencies exist in the income tax liability of petitioner for the calendar year 1944 as follows:

> "Ordered and Decided: That for the taxable year 1944 there is a deficiency in income tax in the amount of $647,410.25 and an addition to tax under section 293(b) of the 1939 Code in the amount of $345,829.80; and that for the taxable year 1945 there is no deficiency in income tax and no addition to tax under section 293(b) of the 1939 Code" (Apx. 52a).

Petitioner's tax return for 1944 was filed on May 15th, 1945. Respondent's statutory notice of deficiency (90 day letter) was served on *July 11, 1956—11 years* after filing, and 8 *years* after the bar of the statute of limitations. On the eve of trial—*11 years* after filing of the tax return under review, and 10 years after the bar of the statute, respondent amended his pleading to charge additional tax liability for alleged capital gains.

The facts established by the uncontradicted proof are as follows:

During the years under review petitioner was engaged in manufacturing ball bearings and airplane engine parts. He employed anywhere from 200 to 300 employees.

Petitioner's business was a one-man operation. He designed the machinery for production. He "made the layouts * * * and the design." He "made the experiments" and "made the production." He took care of sales and financing. Petitioner testified without the slightest impeachment or contradiction:

> "Q. Now did you personally take care of the production that was required? A. I took care of everything in the factory. * * *" (Apx. 169a).

Supervisory personnel of the U. S. Air Corps were in his plant to push production night and day; that during the period under review petitioner worked day and night including Saturdays and Sundays to the point of a near breakdown. He testified, without impeachment or contradiction:

> "Q. And they were right there on your back to push production of the parts that were essential? A. We pushed production, * * * day and night (Apx. 170a).
>
> Q. Is it a fair thing to say that you were a pretty busy man in those days? A. I was very busy. I worked day and night.
>
> Q. Did that include Saturdays and Sundays? A. Saturdays and Sundays, to the point where I pretty nearly broke down" (Apx. 170a).

His business was for a time conducted by a corporation—the American Rolbal Corporation (referred to as "Rolbal")—of which he was the only shareholder. Petitioner organized "Rolbal" in 1937. The corporation was

formally dissolved, pursuant to Statute, in May 1943. The assets consisting in the main of machinery and equipment were transferred at the time to petitioner, effective as of January 1st, 1944.

In 1944 respondent began investigation of "Rolbal" for 1941, '42 and '43. Respondent thereafter asserted tax deficiencies against "Rolbal" (Docket No. 11086—T. C. Memo—1954-67, aff'd on Findings below, 220 F. 2d 749), and petitioner personally (Docket 11085, T. C. Memo 1955, modified and affirmed, 262 F. 2d 809), for these years—viz. 1941, '42 and '43.*

Judge Arundel in his findings in "Rolbal" thus described petitioner's operations:

> "On December 24th, 1937, Lowy formed the petitioner, American Rolbal Corporation. He was the sole stockholder * * * the capital of $10,000 was entirely subscribed for by Lowy. From the beginning of 1938, American Rolbal carried on the business which had been initiated by Lowy as an individual in 1934. The machinery and equipment it used was * * * the same equipment and machinery which Lowy had used while operating in his individual capacity until the formation of American Rolbal. * * * Lowy did not distinguish between Rolbal's financial requirements and his personal requirements. He was of opinion that when his corporation needed money, it was exactly as though he needed money personally. * * * Rolbal had filed

* The issue of scrap omission is involved in the years 1942-1943. For petitioner's imprudence connected with these years where the petitioner's base tax, as transferee of "Rolbal", and personal tax combined, total approximately $170,000, he paid into the U. S. Treasury approximately $690,000 in taxes, penalties and interest—an excess of $450,000 over the base tax liability.

> a certificate of corporate dissolution with the Secretary of State of New York on May 10th, 1943. * * * However, Rolbal continued to operate as a corporation and its 1943 return was filed as though the corporation had been in existence for the entire calendar year" * * * (Apx. 144a, 150a).

When respondent's agents first examined into Rolbal's operation in 1944, they found that, "During the years in issue, the books of American Rolbal were kept by a bookkeeper with occasional guidance and supervision from outside certified public accountants. Until 1943, Michael Liebowitz and his sister were the accountants. Following their departure in May, 1943, Rolbal did not retain another accountant until the early part of 1944, for assistance in preparation of the 1943 return" (Apx. 151a). ("Rolbal" findings, *supra*).

The record is incontestibly clear that in *February, 1945*, petitioner in good faith, determined to put his house in order and avoid any impropriety in respect of future tax liability. He discharged his part-time accountant. On recommendation of his attorney, he retained Morris Berger, concededly a highly qualified certified accountant, to take over the accounting work, to make a thoroughgoing analysis of his business operations, and *to prepare an accurate tax return for 1944*. Berger was informed at the outset of his employment that petitioner was under investigation for 1941, '42 and '43. Berger, *sworn as a witness by respondent*, testified that in February, 1945, petitioner's attorney specifically informed him of the pending investigation for the earlier years and *explicitly* cautioned him about inclusion of the scrap sales proceeds in *the 1944 tax report* (Apx. 122a, 123a, 126a, 127a, 135a).

These were war years. Competent help was scarce. Berger did not seek this accounting job. He took it on,

as he testified, only as a favor to (petitioner's attorney) Garfield (Apx. 121a, 122a). He made a preliminary study and survey. *He discussed the scrap sales with petitioner!* He studied the history of the machinery and equipment to determine its cost and value (Apx. 121a, 123a). He determined that a deduction of $360,000 for machinery and equipment depreciation for the taxable year 1944 would be in order (Apx. 129a). He further determined that in view of the heavy depreciation item, the scrap proceeds, about which he was cautioned (estimated by Berger to be between $15,000 and $20,000), would, in his judgment, have no tax consequence! Working under pressure of time for filing the returns and further handicapped by ck of competent help, *he advised petitioner* that, in the cumstances, it would be appropriate (in Berger's judgnt) to prepare and file a "tentative" tax return for 1944. He told petitioner that later, when eased from the pressure for filing the 1944 return, he would make further study and analysis and thereupon file an *amended 1944* tax return reflecting the scrap and other income and expense items in event they would have bearing on the 1944 net tax result. *Relying upon Berger's advice and counsel, petitioner signed the return prepared by Berger* (Apx. 134a). It was filed on May 15th, 1945 (Ex. 4d, Apx. 139a). Berger was given a completely free hand. No records sought by him were withheld. *There could be no sinister motive and no purpose in concealing records reflecting deposit of scrap proceeds from Berger after petitioner had disclosed them!* In no manner, shape or form did petitioner state or intimate to Berger that he wanted "*any kind of a return other than a completely frank and honest return*" (Apx. 128a). We repeat that Berger testified without impeachment or contradiction that, at the outset of his hiring, he was told of petitioner's prior tax troubles and *cautioned to include the scrap sales*

by both petitioner and his attorney Garfield! (Apx. 122a, 123a, 126a). After Berger had prepared and filed the 1944 return (labelled in his bill "*tentative*") and when working on the 1945 return (when both Berger and petitioner were eased from the pressure of work), every record sought was made available to him (Apx. 123a, 132a). Berger was not insistent upon their earlier production when preparing the *1944 "tentative" return*, not because petitioner was endeavoring to conceal any record but to the contrary, as Berger (respondent's witness) swore, "*because of the fact that he (Lowy) was burdened with a great deal of work*" (Apx. 126-7a, 134a), and more importantly, because of the overriding fact that *on Berger's opinion*, no taxable income would have resulted even had the scrap item been then picked up! (Apx. 122a, 123a, 131a, 132a). Finally in Berger's *bill* to petitioner for professional services for $3,000.00, dated *January 9th, 1946*, covering the period of his employment, he explicitly referred to the 1944 return as a "*tentative*" tax return (Apx. 127a-128a)! (Opinion, Court of Appeals, 288 F. 2d 517, p. 519, *supra*.)

We briefly review the pertinent proof. Berger testified without the slightest impeachment or contradiction:

> "Q. Now, at the time you were preparing this return for the year 1944, did you know whether or not Mr. Lowy had income from scrap sales? A. *I was told by Mr. Garfield that a question as to scrap sales would arise.* But I didn't consider too important at the time, for the reason that the volume of business was not so great that the scrap sales could amount to any very considerable sum. It might amount to $15,000 even $20,000, but not to amount to anything to off-set $200,000 of excess. * * * " (Apx. 123a).

Berger furthermore, swore without the slightest contradiction:

> "Q. Now with respect *to the scrap sales*, I believe you testified that you were told by Mr. Garfield there had been *some prior trouble about it and to look out for it; is that correct?* A. *That is correct.*
>
> Q. *And you had that in mind when you accepted your employment with Mr. Lowy; is that correct?* A. I had that in mind, but the amount of time necessary to discover these items, and the fact that Mr. Lowy didn't have those available at the time, *it didn't mean too much, because of the volume of business the scrap sales, at best, could not have amounted to more than possibly ten per cent of sales, or five per cent of sales.* The sales were limited; I don't recall what they were.
>
> Q. *And with knowledge of that fact, you advised Mr. Lowy that it would be important for him to sign the tax return that you prepared;* is that correct? A. That is correct * * *" (Apx. 135a).

> "Q. And did you not advise Mr. Lowy that he could file this tax sign this tax return and file it in the manner in which you prepared it? A. I did" (Apx. 130a).

Berger further swore:

> "Q. Did you ask Mr. Lowy if he had any other income which was not reflected in the books of the business? A. I did, sir.
>
> Q. What did Mr. Lowy say? A. He said he would submit whatever records he had, and he submitted his personal bank accounts, and if there was anything in there it would reflect additional income *that should be corrected*" (Apx. 130a).

Berger was asked:

> "Q. And do you believe in your own heart and soul that the return you filed was accurate enough so that Mr. Lowy could rely on your opinion and sign it; is that right? A. That is right. I advised him to sign it" (Apx. 133a).

It is to be emphasized that the omitted scrap sales proceeds were all received and deposited in 1944 before Berger's employment. There is not a scintilla of proof that, from the time of Berger's employment in February 1945, anything was concealed from Berger. It does not make sense to say that though told of the scrap, it, in the same breath, was concealed from him!

Berger, in doing his work under stress of the handicaps depicted by him, inadvertently omitted the November and December 1944 sales (Apx. 133a, 134a) made in the ordinary course of petitioner's business (Resp. Ans. Pars. 9 b). This omission was conceded on trial to be without imputation of fraud (Apx. 134a). In April 1946, understandably disturbed over such glaring [illegible] ordinary accounting and with the prospect of trouble, the thing he sought to avoid by employing Berger, petitioner turned to the *New York State Society of Certified Public Accountants* for a man of high competence and caliber to take on Berger's job. He wanted an accountant of outstanding stature to correct Berger's errors, file an *amended tax return for 1944* and prepare the 1945 return! The witness, William B. Miller was then recommended by that professional State Society. It was under these circumstances that Berger was discharged and Miller retained.

Miller was a Certified Public Accountant of long experience and for 10 years taught accounting at Pace College, a fully accredited school of higher learning. He was

employed on April 26, 1946 on recommendation by the N. Y. State Society of Certified Public Accountants (Apx. 78a). Miller called as a witness by respondent testified that his job was to *review the 1944 tax return filed by Berger, correct any errors*, and prepare the 1945 tax return. He was furthermore, to install a more modern and efficient bookkeeping system (Apx. 81a). Miller was specifically informed of petitioner's earlier troubles with the Treasury Department and of Berger's careless omission of the November and December sales from the 1944 return. Miller testified:

> "* * * I had been engaged by Mr. Lowy to amend both the years if necessary—*amend '44 and prepare '45*. The first thing he told me when I was engaged was that that was the thing to do was to amend the '44. I was told that by the people at the State Society, who sent me down, that he was looking for someone to do that" (Apx. 81a).
>
> "A. Well, Mr. Lowy told me the first time we met that he had trouble with the Treasury Department; that he thought errors were made by the previous accountant, and that he felt for that reason he was justified in dismissing him, and he hoped that no such errors would appear again. And for that reason he applied to the New York State CPA Society for what they would recommend as a good accountant. And that is how I got to meet him" (Apx. 82a).

Thus, the decisive uncontradicted proof of respondent's witnesses repels as a matter of law any imputation of petitioner's fraudulent intent to conceal the scrap sales. There was no conflict in the proof on that crucial issue. ***The proof as stated came from witnesses sworn by respondent.***

Reasons for Granting the Writ

1. Devoid of supporting proof, the judgment under review contravenes the "due process clause" of the Fifth Amendment. *Petitioner stands convicted without a scintilla of proof of guilt.*

2. Error was committed in holding (in conflict with the decisions of other Courts of Appeals on the same subject) that, under Federal Tax Law and the U. S. Rules of Civil Procedure, a Trial Judge *has the right under law* to ignore positive, uncontradicted and unimpeached proof of witnesses decisive of the fact issue before him.

3. Error was committed in ignoring and in failing to make findings in respect of uncontradicted, unimpeached proof of witnesses called by respondent upon the crucial issue of fraudulent intent where their proof completely exculpated petitioner of any taint of fraud.

Following is a brief presentation of the arguments in support of the petitioner's contention that the decision of the United States Court of Appeals for the Second Circuit is erroneous:

The Judgment, Holding That Respondent Has Sustained His Burden of Fraud on the Scrap Issue by the Clear and Convincing Evidence, Finds No Support in Law, Being Devoid of Supporting Proof and in Contravention of the Due Process Clause of the Fifth Amendment

Respondent's answer sought deficiencies resting upon allegations of acts "done wilfully, fraudulently and with the unlawful intent to evade and defeat payment of taxes legally due" * * * (Apx. 8a, 9a, 13a). Under Section

1112 of the Internal Revenue Code of 1939, Congress has mandated that "in any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax the burden of proof in respect of such issue shall be upon the Commissioner". Concededly, if respondent failed to carry his burden of establishing "fraud with intent to defeat and evade payment of tax" the Statute of Limitation bars the assessment. This Court and the several Courts of Appeals have uniformly held that the fraud charged by respondent must be established by more than a preponderance of the evidence. The evidence must be clear and convincing!

In Merten's authoritative work on the United States Internal Revenue Code (Vol. 10, Chap. 55, p. 79) the controlling principle is succinctly and comprehensively enunciated in the following language:

> "The fraud must be established by more than a mere preponderance of the evidence. The evidence must be clear and convincing. Where the record is in a sort of equipoise, it cannot be said that the burden of proving fraud may be gathered from circumstances, the piling of inference upon inference hardly qualifies as the clear and convincing evidence by which fraud must be proved".

This restates the settled rule that:

> "Standards stricter than mere preponderance * * * are frequently in the law. Instances of these may be found in the requirement of * * * clear and convincing proof * * * applied in fraud cases. * * *." (*Comm'r.* v. *Ryan*, 238 App. Div. 607).
>
> See Richardson on Evidence—Seventh Edition. Chap. 179, p. 155.

The governing principle is tersely set forth by Chief Judge Hutcheson, writing for the Court of Appeals, in *Olinger* v. *Comm'r*, 234 F. (2d) (C. A. 5) 823 (p. 824) as follows:

> "One of the best definitions of tax fraud is to be found in *Davis* v. *Comm'r*, 184 F. (2d) 86, 87. '*Fraud implies bad faith, intentional wrong doing and a sinister motive. It is never imputed or presumed, and the Courts should not sustain findings of fraud upon circumstances that at most create only suspicion*' ". (Emphasis supplied.)

In *Goldberg* v. *Comm'r*, 233 F. (2d) 316 C. A. 5 (1956), the governing principle is thus enunciated:

> "The fraud which the Commissioner was required to prove to sustain the penalty is actual and intentional wrongdoing with a specific intent to evade the tax. *Mitchell* v. *Comm'r. of Internal Revenue*, (5 Cir.) 1941, 118 F. 2d 308. It is never imputed or presumed and findings of fraud should not be sustained upon circumstances which at *most create only suspicion*. *Olinger* v. *Comm'r. Int. Rev.*, 5 Cir. 1956, 234 F. 2d 823; *Davis* v. *Comm'r of Int. Rev.*, 10 Cir. 1950, 184 F. 2d 86; *Mitchell* v. *Comm'r Int. Rev.*, *supra*. The stressing of the petitioner's criminal record and his previous brushes with those charged with the duty of collecting Federal taxes indicate that possibly, in the language of Chief Judge Hutcheson, 'The case on the issues where the burden was on the Commissioner was presented and tried too much on the theory, "Give a dog an ill name and hang him" ' ". "Citing *Olinger* v. *Comm'r Int. Rev.*, 234 F. 2d 824" (Emphasis supplied.)

Negligence or mistake whether slight or great are not the equivalent of fraud. Mere suspicion of fraud and mere doubt as to the intentions of the taxpayer are not proof of fraud *nor do suspicious circumstances establish fraud. Mitchell* v. *Comm'r*, 118 F. 2d 208, 210 (5th Cir. 1941).

In *Eagle* v. *Comm'r*, 242 F. 2d C. A. 5—1957, the 5th Circuit wrote:

> "The burden is upon the Commissioner to prove affirmatively by clear and convincing evidence actual and intentional wrong-doing on the part of petitioner with a specific intent to evade the tax • • •."

The Court of Appeals (9th Circuit) wrote in *Powell Exr.* v. *Granquist*, 252 F. 2d 56, C. A. 9—1958, p. 61:

> • • • "The existence of fraud • • • is a state of mind of the taxpayer during the period in question with which we are concerned".

In *Davis* v. *Comm'r*, 184 F. 2d 86 (C. A. 10) 1950, the 10th Circuit Court of Appeals wrote:

> • • • "Fraud implies bad faith, intentional wrongdoing and the sinister motive".

The opinion of the Second Circuit Court of Appeals, under review departs from, and is in conflict with, the settled and controlling principles enunciated in the foregoing opinions of the several U. S. Courts of Appeals in dealing with civil tax fraud cases. A study of the opinion shows that its finding of fraud rested upon nothing stronger than suspicion stemming from petitioner's 1941, '42 and '43 tax difficulties. Nothing more! This is palpable error because under tax law "Each year is a sepa-

rate unit". *U. S. v. Lewis*, 304 U. S. 590, and "Proof of fraud for one year will not sustain the respondent's burden of proof of fraud in another year". *Thos. McLaughlin*, 29 B. T. A. 247.

The record may be searched in vain for any proof of petitioner's intentional wrong doing, bad faith, sinister motive, or concealment of scrap sales with intent to evade 1944 tax.

The Courts below ignored the rule firmly established by an unbroken line of decisions, that *suspicion may never be substituted for proof of fraud.*

> "A charge of fraud has always been regarded as a serious matter in law. Not only is it never presumed, but the ordinary preponderance of evidence is not sufficient to establish such a charge. It must be proved by clear and convincing evidence." (*Kerback* v. *Comm'r*, 29 B. T. A. 1014, aff'd 74 F. (2d) 749 C. C. A. 1—1935.)

Concealment with intent to evade tax is an indispensable ingredient of fraud. *Disclosure is the negation of concealment and per se vitiates fraud. Elementary and basic in the concept of due process is the rule that no Court has the right to ignore positive, uncontradicted and unimpeached proof, determinative of the issue under review. Any judgment in violation of this salutary rule runs afoul of the due process clause of the Fifth Amendment. The exculpatory proof was entirely ignored by the Court of Appeals. No findings in respect thereto were made by the Tax Court. This is the basic point of error assigned in taxpayer's petition for certiorari.*

Analysis of Court of Appeals' Opinion

Judge Hand in his opinion of affirmance, wrote in pertinent part:

> "It is true that the return was prepared under great pressure, and with some reserve as to its final correctness; indeed in the bill rendered by Berger to the taxpayer, he described his work as 'preparation of a tentative tax return', a description which in his testimony he called 'ill-chosen', except as it meant that he 'intended to file an amended or corrected return.' He did not, however, suggest in the return itself anything of the kind. It would, of course, have been possible that these six items were omitted in 1944 by accident, but Berger did not give this as his reason. Rather, he said that there was such a large deficiency in income—about $200,000—that 'any adjustments of income would have to be very, very considerable in order to overcome that deficiency.' *That would have had some plausiblity, were it not for the fact that, as we have said 'the taxpayer had made the same kind of omission in 1942 and 1943*, for both of which he was later held liable ' * * * " (pp. 1273-4, Opinion). (Emphasis supplied.)

> "As we understand the petitioner's argument, it is that, even though the suppression of the 'scrap sales' was intended to prevent their detection and assessment as part of the petitioner's income, his omission of them from the return could not have been with intent to evade tax" (§ 276 Int. Rev. Code) for they were not taxable anyway because the return so much overstated the deficiency. In short, on the face of the return there would have been no income to tax even if the "scrap sales" had

> been disclosed. Consequently, the petitioner argued, that he could not have intended to 'evade the tax,' for he did not need to suppress the 'scrap sales.' "

The opinion of Judge Hand further notes that—

> " * * * Fraud is an issue depending upon the payer's intent. *Helvering* v. *Kehoe*, 309 U. S. 277; *National City Bank* v. *Helvering*, 98 Fed. (2) 93 (C. A. 2); *Hegman* v. *Commissioner*, 176 Fed. (2d) 389, 393 (C. A. 2). When a taxpayer has himself testified, the decision of the tax court has the same finality as the finding of a district court—that is, it must be accepted unless it is "clearly erroneous.' We can only conclude that the petitioner in the case at bar meant to leave out his receipts from 'scrap' in order to conceal them from the taxing authorities. This was a 'fraud', but it so happened that the deficiency alleged in the return was much greater than the amount of the 'scrap' sales, and that any income resulting from the sales was therefore much more than matched by the deficiency. However, upon the audit of the return it was discovered that the petitioner had omitted large receipts that extinguished the deficiency and made the 'scrap sales' taxable as income received. Both parties concede that these omissions were not fraudulent, and we accept them as innocent mistakes. * * * "

The erroneous misreading of the record is at once apparent!

FIRST: The Court overlooked that petitioner *hired* Berger with the injunction *to include these very scrap sales because of trouble brewing from their omission in*

1942, '43 tax returns, long before any investigation of the 1944 return. To ignore this exculpatory proof decisive of the critical issue of "intent to evade" is *tantamount to denial of due process!*

SECOND—The Court of Appeals entirely missed the point of petitioner's argument. *The point is that there was no proof of any wilful suppression.* The error in judgment resulting in omission of the scrap sales, was *Berger's* error and not *petitioner's*. The "tentative" 1944 return was filed on Berger's advice. It was Berger who *failed* to note on the *tax return* that it was intended as *tentative!*

In sum, a finding that the taxpayer was guilty of wilful, fraudulent evasion and concealment in respect of the $13,000 scrap sales omissions from the 1944 tax return when the evidence shows (a) that there was disclosure of such proceeds to the accountant; that he was cautioned about their inclusion and (b) that the taxpayer, long before any investigation of the 1944 tax return, discharged Berger upon the discovery that he had negligently omitted approximately $200,000 ordinary sales for November and December 1944 and (c) that petitioner thereupon turned to the N. Y. State Society of Certified Public Accountants for a high-calibre accountant to correct this omission and if necessary, file an amended 1944 return, can find *no rational* basis. It is accordingly repugnant to the due process clause.

THIRD—A reading of the opinion makes it clear that there was failure to credit decisive, unimpeached and uncontradicted proof on the decisive fact issue. This Court has repeatedly ruled that findings devoid of factual proof are offensive to due process. This fundamental rule was re-enunciated and applied by this Court in the cases of *Thompson* v. *City of Louisville*, 362 U. S. 199 (1960);

Schare v. *Board of Bar Examiners, State of N. M.*, 353 U. S. 232, 249 (1957); *U. S. ex rel. Vajtauer* v. *Comm'r*, 273 U. S. 103-106; *Moore* v. *Dempsey*, 261 U. S. 86; *Mooney* v. *Holohan*, 294 U. S. 103.

In *Schare, supra*, Frankfurter, J., writing for the Court states the governing principle as follows: "* * * A consideration that offends the dictates of reason offends the due process clause."

The assertion has been frequently made that due process of law in judicial proceedings is a rule of action that accords with fundamental principles of free government. In essence, simply put, it means that no man shall be cast in judgment—civil or criminal—without proof. Upon this record petitioner, nevertheless stands convicted though the record is barren of legal proof of guilt!

A. The Courts Below Erred (in Conflict With Decisions of This Court and the Several Courts of Appeals) in Failing to Give Probative Force to Decisive, Uncontradicted and Unimpeached Proof of Witnesses Upon the Decisive Fraud Issue.

B. Respondent Having Called These Witnesses in Support of His Burden of Proof Is Bound by Their Testimony.

The Court of Appeals wrote:

> "Finally we do not agree that the testimony of the respondent's witnesses was conclusive in petitioner's favor because the respondent called them. *It may be true that courts at times said the contrary or nearly as much, but the notion is thoroughly discredited, that 'When a party calls a witness, he is bound by that witness's story'.*" (Emphasis supplied.)

This ruling is in conflict with rulings on the same subject by other Courts of Appeals and repugnant to principles deeply embedded in federal and state jurisprudence.

The rule is basic and fundamental that unimpeached and uncontradicted testimony, not inherently incredible must be accorded probative force as matter of law.

In *Corpus Juris Secundum*, the rule is stated in the following language:

> "Uncontradicted or undisputed evidence should ordinarily be taken as true. More precisely evidence which is not contradicted by positive testimony or circumstances, and is not inherently improbable, incredible or unreasonable, *cannot be arbitrarily or capriciously discredited*, disregarded or rejected * * * and unless shown to be untrustworthy is to be taken as *conclusive and binding on the tryer of the facts.* * * *" (Emphasis supplied.)

This principle far from being "*thoroughly discredited*" as held by the Second Circuit Court of Appeals, in this case, is the law in every State, and is uniformly applied under federal tax law. *Grace Bros. Inc.* v. *Comm'r*, 173 F. 2d 170, 174 C. A. 9—1949. The 9th Circuit Court of Appeals in passing upon an income tax litigation, wrote:

> "It is 'axiomatic that uncontradicted testimony must be followed. *Chesapeake & Ohio R. Co.* v. *Martin*, 283 U. S. 209, 216, 217—1931; *San Francisco* v. *Industrial*, 152 F. 2d 532, 536—C. A. 8—1946; *Foran* v. *Comm'r*, 165 F. 2d 705—C. A. 5—1948. The only exception to the rule occurs when we are dealing with testimony by witnesses who stand unimpeached and whose testimony is contradicted by the testimony of others or by physical or other facts actually proved or with testimony which is inherently improbable."

The rule is reaffirmed in the following highest State Court cases: *Harr* v. *Wells-Newton*, 278 N. Y. S. 733-244 App. Div. Aff'd 269 N. Y. 531, 199 N. E. 521; *Smith* v. *U. S.* (D. C. Ky.), 5 F. Supp. 475; *St. Louis* v. *Williams*, 21 W. S. 2d 611, 180 Ark. 413; *Hollenbough* v. *Wickersheim*, 299 P. 90, 114 Cal. App. 1; *Ruff* v. *Cooper*, 169 So. 490-124 Fla. 876; *Barrington* v. *Davis*, 162 S. E. 642, 44 Ga. App. 682; *Piersdoff* v. *Gray*, 74 P. 2d 171, 58 Idaho 438; *Cusanelli* v. *Steele*, 5 N. E. 2d 296-287 Ill. 490; *Abel* v. *Love*, 143 N. E. 515, 81 Ind. App. 328; *Pike* v. *Corn*, 252 N. W. 888, 217 Iowa 1068; *U. S. Rubber* v. *Browne*, 150 S. W. 2, 661-286 Ky. 147; *England* v. *Aetna Life*, 280 N. W. 771, 285 Mich. 302; *Cleveland Ry. Co.* v. *McManus*, 32 N. E. 2d 66 Ohio; *Burke* v. *Kennedy*, 135A, 508, 286 Pa. 344; *Frank* v. *Wright*, 205 S. W. 434, 140 Tenn. 535; *Albright* v. *Smith*, 288 S. W. 178 Texas; *Bice* v. *Bice*, 244 p. 1000, 138 Wash. 598; "Evidence which is uncontradicted by fact or inference deducible therefrom is taken as true, as matter of law". *Williams* v. *Cohn*, 206 N. W. 823, 101 Iowa 1121.

At no time did the Commissioner contend that Berger's testimony was inherently incredible or in any wise impeached. Nor did the Court below even hint that his proof lacked credence. In the circumstances the controlling and determinative rule is thus enunciated in Chapter 1040 *Corpus Juris Secundum:*

> "*As a general rule, the party calling a witness vouches for the credibility of and is bound by his testimony unless it is contradicted, or is of an unreliable character.*"

Tax Court trials are conducted in accordance with rules of evidence applicable in trials without a jury in the U. S. District Court for the District of Columbia (Rule 31—T. C. Rules). Rule 43(b) of the Rules of Civil Pro-

cedure for the U. S. District Courts in pertinent part, authorizes impeachment only of *an adverse party* by *the party calling him.* It supports the fundamental rule that "The law will not permit" a party calling a witness * * * "to impeach * * * their credibility." (Richardson on Evidence, Seventh Ed. Chap. 507, p. 536.)

The governing principle was re-enunciated and applied under Federal law in *Wright-Bernet* v. *Comm'r*, 172 F. 2d 343—1956 in the following words: "* * * As the petitioner's witnesses were unimpeached and no evidence was given to the contrary, their testimony should have been accepted"—citing *Capital* v. *Comm'r*, 131 F. 2d 712 — 6th Circuit.

To the same effect is *Wellington* v. *Comm'r.*, 196 F. 2d 421 (C. A. 7—1952).

In *Chesapeake & Ohio* v. *Martin*, 283 U. S. 209 216, this Court re-affirmed the governing principle that unimpeached and uncontradicted proof may not be arbitrarily rejected, where "* * * The *witness was not impeached and there was nothing in the record which reflects unfavorably upon his credibility*". (Emphasis supplied.)

The rejection of the principal rule upon the ground that it is a "notion * * *" "now thoroughly discredited" finds no *support in law.*

Finally, the Court of Appeals in its opinion of affirmance, comments: "It is true that the return was prepared under great pressure, and with some reserve as to its final correctness; indeed, in the bill rendered by Berger to the taxpayer, he described his work as 'preparation of a tentative return' * * * it meant that he 'intended to file an amended or corrected return'. He did not, however, suggest *in the return itself anything of the kind*". (Emphasis supplied.)

The Court overlooks, however, that the uncontradicted proof establishes (a) the omission of the scrap sales from the report and (b) failure to label the tax return "tentative" was *Berger's* and *not* taxpayer's negligence. No fraud may be attributable to the petitioner from this circumstance.

> "Fraud is more than a mistake in judgment. If the factor of judgment really enters into a decision to do or not to do, a particular thing, which ever course is taken could hardly be called fraudulent". (Merten's Law of Fed. Income Taxation Vol. 10 55.14.)

The miscalculation which induced Berger to omit scrutiny of the scrap sales depositories, and their inclusion in the return, was Berger's miscalculation. The argument that though Berger was informed of the scrap, there was intent in the same breath to conceal the scrap, is offensive to common logic. *In logic, reason, and law, this point must be answered.* But it was evaded in respondent's brief and in the opinions of the courts below.

The Court of Appeals in its opinion puts the crucial issue in the following words:

> "The question is whether this return for 1944 was fraudulent as an effort to suppress more than $13,000 of income that petitioner concededly had received during that year".

At the risk of repetition but in view of the gravity of the issue to petitioner, we again summarize the decisive and controlling exculpatory proof upon that crucial issue *which the courts below totally ignored.*

(a) Accountant Berger was employed in February of 1945 on recommendation of petitioner's attorney to cor-

rect petitioner's prior irregularities, and to prepare and file a correct and honest 1944 tax return (Apx. 128a).

(b) That Berger was then informed of petitioner's earlier tax troubles and specifically cautioned about the inclusion of the scrap sales in the 1944 return and that Berger "*had that in mind*" when he accepted his employment (Apx. 135a).

(c) That Berger in preparing the return, discussed the scrap sales with petitioner and didn't press him for details "because of the fact that he (petitioner) was burdened with a great deal of work at that time", and not because they were suppressed by fraud (R. 164), and more importantly because "*I* (Berger) *don't consider it important at that time*" (Apx. 123a).

(d) That Berger estimated the scrap at not more than $15,000 or $20,000 (Apx. 123a) and that in his opinion, such omission could not have affected the then tax liability.

(e) That Berger intended at all times when relieved of the extraordinary pressure of work, to file an amended return which would then correct any omissions (Apx. 123a).

(f) That Berger labelled the 1944 tax return in his bill to petitioner as "*tentative*" with the explanation that the word was ill-chosen and that what he intended was to file an *amended return* (Apx. 128a).

(g) That with knowledge that the scrap proceeds were not reflected in the return and though cautioned about their inclusion, he (Berger) nevertheless advised petitioner that in the circumstances it would be appropriate to sign the return as prepared by him (Apx. 123a).

(h) That when an error in ordinary accounting appeared, namely, the omission of year end 1944 sales in the amount of approximately $175,000 (long before the

1944 return was under investigation) petitioner discharged Berger and applied to the New York State Society of Certified Public Accountats for a man of high competence to *correct* Berger's omissions, *file an amended 1944 return* and take on the accounting work.

(i) That Miller testified without the slightest contradiction that "* * * the first thing that he (petitioner) told me when I was engaged * * * was to *amend the '44*. I was told that by the people at the State Society who sent me down * * * that he thought errors were made by the previous accountant (Berger) and that he felt for that reason he was justified in dismissing him, and that *he hoped that no such errors would appear again*" (Pet. Apx. 82a).

(j) Finally, the omitted November and December 1944 sales (conceded without imputation of fraud, Apx. 23a included in the 1945 sales Apx. 136a) were stipulated to be in the amount of $175,372.50. Berger testified "I had it at $193,000 when I analyzed the income for 1945" (Apx. 133a). Here the correct figures, on audit, represent an *error* by Berger *against* petitioner to the extent of *$17,627.50* more than enough on this single item to offset the omitted scrap of *$13,509.88!* (Emphasis supplied.)

All this negates fraud as matter of law!

Scrupulous observance of the firmly established rule that uncontradicted proof of unimpeached witnesses may not be arbitrarily rejected by the trier of the facts, is vital to the preservation of our system of "Equal Justice under Law". That rule is part of the "Law of the Land". Its arbitrary rejection would impair and make a shambles of the orderly administration of justice. "The history of liberty has largely been the history of observation of procedural safeguards" (Frankfurter, J.)

Conclusion

The judgment below rests on nothing stronger than inference founded upon suspicion. Under basic law, deeply embedded in our jurisprudence, suspicion cannot take the place of proof. Scrutiny of the record, barren of proof, makes it inescapably clear that petitioner has been denied due process in contravention of the Fifth Amendment.

Strikingly apposite is the language of Chief Judge Hutchins, writing for the court, in *Olinger* v. *Comm'r*, *supra*, 234 F. (2d) 824, where, in reversing the Tax Court's findings of fraud against the taxpayer, he wrote:

> "The case on the issues where the burden was on the Commissioner was presented and tried too much on the theory 'Give a dog an ill name and hang him.'"

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Dated: New York, N. Y.
June 27, 1961.

Respectfully submitted.

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MAURICE V. SELIGSON,
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Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

(288 F. 2d 517)

No. 194 October Term, 1960

(Argued February 17, 1961 Decided April 4, 1961)

Docket No. 26545

LEO L. LOWY,

Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Before:

CLARK, SMITH and HAND,
Circuit Judges.

On petition for review of a decision of the Tax Court of the United States, Russell E. Train, Judge.

MAURICE V. SELIGSON, for the Petitioner.

LLOYD J. KENO, for the Respondent.

HAND, Circuit Judge:

This case arises upon a petition to review a deficiency in the petitioner's income taxes for the year 1944. In his return for that year the petitioner showed a loss of nearly $200,000, which the Commissioner on audit changed to a tax due of over $600,000 which together with a 50% fraud penalty and interest is claimed to create a total tax liability of $1,600,000. The Commissioner's figures are not disputed, but the assessment was barred by the Statute of Limitations on May 15, 1948—three years after the date when the return for 1944 was filed. The Commissioner argues that the petitioner was not entitled to invoke the bar of the Statute because he had been guilty of fraud in his return for 1944. The basis for this charge is as follows. The petitioner for several years before 1944 had been engaged in the manufacture and sale of airplane parts, his business being conducted by a corporation, called the American Rolbal Corporation, of which he was the only shareholder. All the assets of this corporation were transferred to the petitioner individually in May, 1943, but both parties agreed that the transfer should be treated as though it had been made on January 1, 1944, that being the mutual intention. The critical issue is whether as we have said, the tax return for 1944 was fraudulent in the sense that it tolled the Statute of Limitations, and allowed the Commissioner to tax the income at the much increased amount, which he had failed to do within the statutory period of three years. The charge of fraud rests upon the following facts.

The taxpayer's business involved the production of large amounts of steel "scrap" which means small pieces of steel ground off larger pieces in the manufacture. These are waste metal so far as concerns their use, but they have a value nevertheless, which amounted in the year 1944 to more than $13,000. The taxpayer did not

deposit this money in his bank through which he did business. On the contrary, he divided it among six bank accounts in sums running in 1944 from about $6,000 to $11. Four of these accounts were in the name of the petitioner and his wife jointly. The largest was in his wife's name alone and the next largest was in his own name. He employed two tax accountants, Berger and Miller, to prepare his individual returns for the years 1944 and 1945. The return for 1944 was made by Berger who had never seen the "scrap" accounts until after the return was filed; nor had Miller heard of the asset until after the return for 1944 had been filed. The question is whether this return for 1944 was fraudulent as an effort to suppress more than $13,000 of income that the petitioner concededly had received during that year.

The return for 1944 did not include any part of the "scrap" sales at all, and of the receipts from these sales only about $3,500 was deposited in the taxpayer's personal accounts. About $6,000 was deposited in his wife's account and about $3,000 in the joint account. No explanation is given for these deposits which made up more than two thirds of all "scrap" receipts for the year. Moreover, in 1942 and 1943 neither the returns of the corporation, nor of the taxpayer contained any of the sums for "scrap" sales although in 1942 the amount was over $14,000 and in 1943 over $5,000. It is impossible in the light of these three years to avoid the conclusion that it had been the taxpayer's habit deliberately to conceal from his taxable income some part at any rate of the "scrap" sales. The excuse for so doing in 1944 is to the last degree unreliable. It is true that the return was prepared under great pressure, and with some reserve as to its final correctness; indeed in the bill rendered by Berger to the taxpayer he described his work as "preparation of a tentative tax return," a description which in his tes-

timony he called "ill-chosen," except as it meant that he "intended to file an amended or corrected return." He did not, however, suggest in the return itself anything of the kind. It would of course, have been possible that these six items were omitted in 1944 by accident, but Berger did not give this as his reason. Rather, he said that there was such a large deficiency in income—about $200,000—that "any adjustments of income would have to be very very considerable in order to overcome that deficiency." That would have had some plausibility, were it not for the fact that, as we have said, the taxpayer had made the same kind of omission in 1942 and 1943, for both of which he was later held liable.

Fraud is an issue depending upon the payer's intent. *Helvering* v. *Kehoe*, 309 U. S. 277; *National City Bank* v. *Helvering*, 98 Fed. (2) 93 (C. A. 2); *Heyman* v. *Commissioner*, 176 Fed. (2d) 389, 393 (C. A. 2). When a taxpayer has himself testified, the decision of the tax court has the same finality as the finding of a district court—that is, it must be accepted unless it is "Clearly erroneous." We can only conclude that the petitioner in the case at bar meant to leave out his receipts from "scrap" in order to conceal them from the taxing authorities. This was a "fraud," but it so happened that the deficiency alleged in the return was much greater than the amount of the "scrap" sales, and that any income resulting from the sales was therefore much more than matched by the deficiency. However, upon the audit of the return it was discovered that the petitioner had omitted large receipts that extinguished the deficiency and made the "scrap sales" taxable as income received. Both parties concede that these omissions were not fraudulent, and we accept them as innocent mistakes. Nevertheless, the result of the audit was to expose the "scrap sales" as income against which there was no correspond-

ing deficiency. Since the "scrap sales" were suppressed by fraud, they were open to assessment in spite of the bar of the statute. When a return is in any part fraudulent "The tax may be assessed * * * at any time" (§276 Int. Rev. Code 1939). As we understand the petitioner's argument it is that, even though the suppression of the "scrap sales" was intended to prevent their detection and assessment as part of the petitioner's income, his omission of them from the return could not have been "with intent to evade tax" (§276 Int. Rev. Code) for they were not taxable anyway because the return so much overstated the deficiency. In short, on the face of the return there would have been no income to tax even if the "scrap sales" had been disclosed. Consequently, the petitioner argued, that he could not have intended to "evade the tax," for he did not need to suppress the "scrap" sales.

We answer, however, that, if a return be fraudulent in any respect with intent to evade a tax, it deprives the taxpayer of the bar of the statute for that year, and permits a general reaudit of the return throughout, and will toll the Statute of Limitations on the reaudit of any item of the tax. In the case at bar there can be no possible doubt that the omission of 1944, like those of 1942 and 1943, was designed to protect the petitioner from income taxes that might otherwise be levied in one form or another. We read the section as tolling the bar of the Statute if the taxpayer has used fraud to interfere in any way with the collection of his taxes. If he would invoke the Statute, he must let the audit of his tax be made without any fraudulent intervention in the year in question. This the petitioner did not do.

Finally, we do not agree that the testimony of the respondent's witnesses was conclusive in petitioner's favor because the respondent called them. It may be true that

courts have at times said the contrary, or nearly as much, but the motion is thoroughly discredited that, when a party calls a witness he is bound by that witness's story. The taxpayer in the case at bar was attempting to avoid any possible liability from a tax that turned out to be owing; this he did by the most obvious misrepresentation. It would be a shocking instance of injustice, if this attempt were to succeed.

We decline to relieve the petitioner from his stipulation.

Order affirmed.

Appendix B

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

26545

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fourth day of April, one thousand nine-hundred and sixty-one.

Present:

HON. LEARNED E. HAND,
HON. CHARLES E. CLARK,
HON. J. JOSEPH SMITH,
Circuit Judges.

LEO L. LOWY,

Petitioner,

AGAINST

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appeal from the Tax Court of the United States.

This case came on to be heard on the transcript of record from the Tax Court of the United States and was argued by Counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said Tax Court of the United States be and it hereby is affirmed.

Filed April 4th, 1961
A. Daniel Fusaro, Clerk
U. S. Court of Appeals
Second Circuit

A. DANIEL FUSARO,
Clerk

Appendix C

Statutes Involved

Internal Revenue Code of 1939:

"Sec. 275. Period of Limitation Upon Assessment and Collection.

Except as provided in Sec. 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceedings in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

"Sec. 276 (a) False return or no return. In the case of a false or fraudulent return, with intent to evade tax * * * the tax may be assessed, or a proceeding in Court for the collection of such tax may be begun without assessment, at any time."

"Sec. 1112. Fraud. In any proceedings involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the secretary or his delegate."

Provision of United States Constitution Involved

The Fifth Amendment to the United States Constitution provides insofar as pertinent:

"* * * nor shall any person be subject for the same offense to be twice put in jeopardy * * * nor be deprived of life, liberty or property without due process of law: * * *"